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The Conference Board

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Economic Times

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Serving Business and Society for 75 Years

Editor's Note

This month we again offer our quarterly round-up on the outlook for various industries — see the special (shaded) center section — prepared by specialists in each of the industries.

Next we have some fascinating facts about state lotteries. I can remember when gambling was widely thought to be a sin, but now you're almost unpatriotic if you don't support education by buying a lottery ticket.

Speaking of sin, our next item presents some new international data on debt — data compiled by C. J. Lawrence Inc., to whom we are grateful — comparing the use of debt in four major countries. Then still another thought about the credit markets is provided by John Paulus.

On the opposite page, our faithful Colloquium panel ranges widely across the horizon in telling us about the most important issues the country faces today. Interestingly, debt is not mentioned.

Ed Fiedler

Maxim of the month:

Smile! It makes them wonder what you're up to!

Who Killed Eastern Airlines?

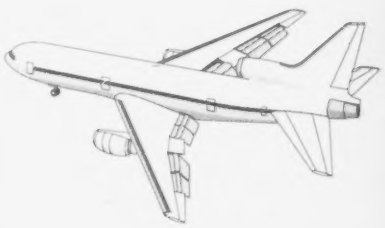
Eastern Airlines is gone and, although I sometimes wax nostalgic, not this time. I'll shed no tears for Eastern.

Most news stories about the event labeled it a disaster and pursued an inquisition to identify the guilty parties. There is of course a long line of "usual suspects," including Saddam Hussein, the regulators, and the deregulators. Former CEO Frank Lorenzo was perhaps the most "popular" choice. He in turn wrote an "op-ed" piece blaming earlier management, the National Mediation Board, and (mostly) the labor unions. The head of the flight-attendants' union responded in kind with a letter-to-the-editor returning the onus to Lorenzo. The flap was mostly babel, generating little light.

But Eastern's demise doesn't deserve a noisy scapegoat search any more than it deserves tears. Why not? Because little if any damage is being inflicted on the economy. Yes, the investors are stuck, but that's standard. And some travelers are left with unusable tickets, and some employees will have to find new jobs, not easy in short order when tied (as most of us are) to a local community.

But for the economy as a whole, what havoc has Eastern's disappearance wrought? Is there a shortage of capacity on the New York-Florida run? Clearly not. Have fares to Puerto Rico skyrocketed in response to a sudden absense of competition? Again, no. Other airlines have bought up Eastern's gates and landing rights. Few passengers have been denied a wide choice of flights on the routes that Eastern flew.

The way the media handled Eastern's demise, it seems to me, is rather typical of our attitude about such developments. Bankruptcy is always thought of as a catastrophe and as a failure of the economy. But think back! Does anyone miss Packard or Studebaker? How about W.T. Grant? Or Braniff? Duz doesn't do everything any more, but somehow we still get our clothes clean. Any mourners for Wings cigarettes? Or *Look* magazine?



The point is that what has happened to Eastern, while not an everyday occurrence, is really just standard procedure in our competitive system. The inefficient and stodgy companies are *supposed* to give way to the innovative and efficient. Competition always looks chaotic and wasteful, especially if viewed from inside a company that's affected. Even when viewing it from an economy-wide perspective, it's a mistake to expect competition to be neat and orderly.

But the reality is that the occasional failure of inefficient firms, widely regarded as "bad news" for the economy, is in fact normal and beneficial to society. Indeed it is a crucial part of the process by which the nation's standard of living improves. No fun for the firm's employees and investors, to be sure, but normally good for all the rest of us. Thus, no tears for you, Eastern Airlines.

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Colloquium

Background:

The Gulf War, a great success, is over and attention is turning again to the many economic and social problems we must deal with near- and long-term, at home and abroad.

Question:

To your way of thinking, what is the most important issue we face now?

Jim Tobin
Yale University

It's time for us Americans, beginning with President Bush, to climb down from our euphoric patriotic high as Number One in warfare and confront our Number One status in urban pathologies — homicides, guns, crimes, incarceration, addiction, homelessness, poverty, dependency. Improvements in health, education, housing, employment, and family stability in inner cities are our most important issues, national as well as local. Enough of empty rhetoric! Let's have real and sustained presidential leadership, federal money too.

Robert G. Dederick
Northern Trust Company

With the recession still proceeding apace, the key issue for most of us — economists definitely not excluded — is our own income, current and prospective. But, when taking a less personal view, I conclude that the most *pressing* issue for the American superpower is how best to deal with the continuing dissolution of the Soviet empire, while the most *important* issue is how best to achieve lasting peace in the Middle East. Or perhaps it's the other way around.

Andrew F. Brimmer
Brimmer & Company

In the Post-Gulf-War period, the most pressing economic problem we face as a nation is the stimulation of *investment* — in plant and equipment, R&D, public infrastructure, and human capital. To meet this need, Congress should adopt a series of sharply focused incentives tied to specific reductions in corporate and personal income taxes. These should include a sizable investment tax credit and substantial allowances for education and training — but *not* lower taxes on capital gains.

Murray Weidenbaum
Center for the Study of American Business

Considering the many members of Congress eager to spend the nonexistent peace dividend and to enact more rounds of burdensome legislation, the major public policy challenge now facing the country is how to get them to leave quickly. Like the ancient Chinese who paid physicians when they were well, we should give members of Congress stipends for staying home. If they must legislate, their motto should become, "Don't just stand there, undo something."

Members:

Members of The Conference Board Economics Colloquium are: Stephen H. Axilrod, Vice Chairman, Nikko Securities International; Andrew F. Brimmer, President, Brimmer & Company; Don R. Conlan, President, Capital Strategy Research; Robert G. Dederick, Executive Vice President and Chief Economist, Northern Trust Company; John T. Dunlop, Lamont University Professor Emeritus, Harvard University; Lyle E. Gramley, Senior Staff Vice President & Chief Economist, Mortgage Bankers Association; Isabel V. Sawhill, Senior Fellow, The Urban Institute; Charles L. Schultze, Senior Fellow, The Brookings Institution; James Tobin, Sterling Professor Emeritus, Yale University; Laura D'Andrea Tyson, Professor of Economics, University of California, Berkeley; Charls E. Walker, Chairman, Charls E. Walker Associates; Murray Weidenbaum, Director, Center for the Study of American Business; Albert M. Wojnilower, Senior Advisor, First Boston Corporation.

The Economics of State Lotteries

by Charles T. Clotfelter and Philip J. Cook

The implicit taxes levied on the purchase of lottery tickets are extraordinarily high.

State lotteries are notable for their broad market penetration and rapid growth. Since 1963, 32 states and the District of Columbia have created lotteries, and it's a good bet that other states will follow in the next few years. Sixty percent of the adults in lottery states play at least once in a year. The annual growth in real per capita sales in lottery states has averaged 12 percent from 1975 to 1989.

On average, half of all lottery revenues are returned in the form of prizes, a ratio that is much lower than that offered by other forms of commercial gambling such as bingo (74 percent), horseracing (81 percent), or slot machines (89 percent). The "profit" goes to the state treasury. These transfers can be thought of as implicit taxes levied on the purchase of lottery tickets, and are extraordinarily high, averaging 40 percent of gross revenues.

The product line offered by state lotteries today bears little resemblance to the games available in the early 1970s. The lotteries' first major innovation was the instant game ticket, offering players a chance to discover immediately if they had won a prize. The second new lottery product was a daily numbers game, a computerized imitation of the illegal game that has long been popular in many cities. This game (like its illegal counterpart) lets players choose their own numbers, thus providing an opportunity to become actively involved in the gambling process.

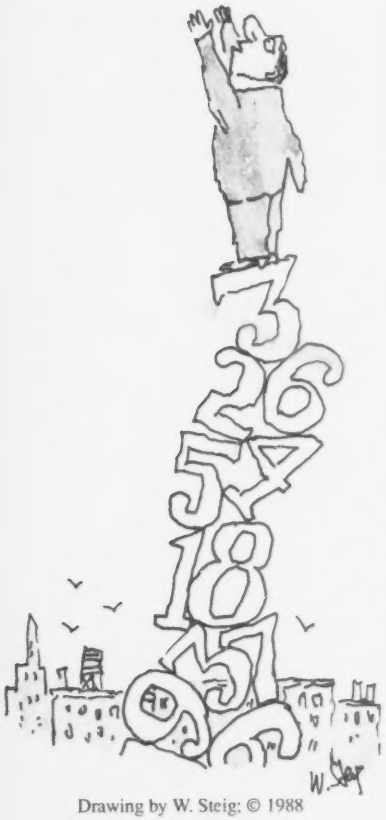
The on-line computer network that supports the numbers game also made it possible to offer a third major lottery product in the early 1980s: lotto. This game features long odds and huge jackpots that build from one drawing to the next if there are no winners. With jackpots reaching as high as $100 million, lotto has garnered enormous public interest.

Why People Play

A lottery ticket is a risky financial asset, offering a prospect of prizes in return for an investment of 50 cents or a dollar. Since the expected value of the prizes is typically only half the ticket price, the question naturally arises as to why the risky prospects offered by lottery games appeal to people who exhibit some aversion to risk in other circumstances. One argument is that people who gamble at unfavorable odds may perceive a disproportionate benefit to a prize that is large enough to elevate their social standing, and be willing to pay a premium for that sort of chance.

A quite different explanation is that when the odds against hitting the jackpot are several million to one, such probabilities are well beyond the realm of experience gained from playing the game, and as a result players cannot be expected to have much intuition about their chances. Faced with such a remote chance, people tend to assess the prospect on the basis of considerations such as the ease with which instances of the event can be brought to mind. In the case of lotteries, the ability to visualize such instances is aided by the steady stream of winners who are announced each week with considerable fanfare and by the advertising.

Lottery advertising accentuates the possibility of winning with themes like, "Somebody's going to win. Why not you?" Such messages, implicit or explicit, help make the dream of wealth credible. Such ads may tend to produce an exaggerated sense of the likelihood of winning. A gamble which is objectively unfair may thus be perceived as



Drawing by W. Steig; © 1988
The New Yorker Magazine, Inc.

attractive by people who normally are averse to risk.

Who Plays the Lottery?

Most adults who live in lottery states have played the lottery at least once, but a small percentage of lottery customers are so active as to account for the bulk of all sales. In any given week about one-third of all adults play.

Socioeconomic patterns of lottery expenditures have received considerable attention. Men play somewhat more than women. Adults play more in their middle years than when young (18 to 25) or old (65 and over). Catholics play more than Protestants, approximately half again as much. And lottery play is systematically related to social class, although perhaps not always as strongly as the conventional wisdom would suggest in this regard. A survey in California found that the proportion of adults who participated during one week in July 1986 ranged from 49 percent for those with less than a high school education to 30 percent for those with a college degree. Retired people and students played least of all. With respect to race, survey evidence suggests that Hispanics in the west and blacks in the east play more than non-Hispanic whites.

Remarkably, the same sources of data do not demonstrate any consistent relationship between lottery play and household income over the broad middle range; the average expenditure in dollars for households making $10,000 is about the same as for those making $60,000. One implication of this pattern of demand is that the tax implicit in lottery finance is regressive, in the sense that as a percentage of income, tax payments decline as income increases.

The tax implicit in lottery finance is regressive. But the prizes are the stuff that dreams are made of.

The Peculiarities of Lotto

For the game of lotto, bigger is better. Small states appear to be unable to mount a lotto game that attracts much public interest because the jackpots are inevitably small compared to the multi-million-dollar bonanzas generated in California and New York. The reason hinges on the role of the jackpot in attracting lotto action. An example may help explain how this works.

Suppose state A has an adult population of 10 million and state B has only 100,000. Given equally attractive games, we assume that lotto purchases in both states will average $1 per capita at each drawing. In state A the initial jackpot is then worth $2.5 million, compared with only $25,000 in state B. If both states set the probability of winning at 1 in 100,000 with the average price per winner the same in both states, then state A will have an average of 100 winners while state B will have one winner. Given these rules, the games in the two states do not appear to differ much. However, state A has the option of reducing the probability of winning to, say, 1 in 10 million, in which case each state has only one winner on the average.

Under these rules, state A offers one hundred times the jackpot of state B, and only 1 percent of state B's probability of winning. For reasons discussed above, most players prefer state A's game to state B's. The prize in state A is the stuff that dreams are made of. The offsetting large difference in probabilities between the two states has little influence on potential players. As long as most drawings produce a winner, the prospect of winning will be credible in both states.

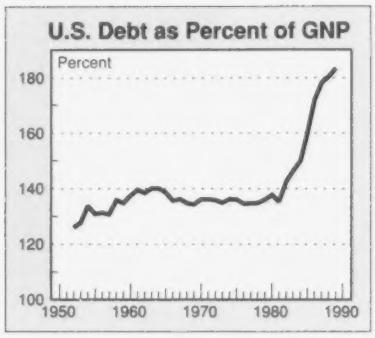
What's the Purpose?

As they are presently constituted, state lotteries are guided by one objective: to raise as much revenue as possible for state treasuries. This is evident in the lotteries' high tax rates and heavy advertising. The lottery agencies could increase payout rates to levels typical of other forms of commercial gambling, increasing consumer surplus at the expense of state revenue collections. Another option would be to require lottery agencies to disclose more information on the probability distribution of prizes, and to be more candid in characterizing the value of jackpots paid out in the form of annuities. Restrictions on advertising, of the sort currently in effect in Virginia and Wisconsin, could be adopted in other states. However, states appear to have little enthusiasm for making any major changes in what has become a popular and profitable formula for raising revenue.

Excerpted from the *Journal of Economic Perspectives*, Fall 1990. Charles T. Clotfelter and Philip J. Cook are professors of Public Policy Studies and Economics at Duke University, Durham, North Carolina. Their book, *Selling Hope: State Lotteries in America*, was published by Harvard University Press in 1989.

Till Debt Do Us Part

By Edgar R. Fiedler



The hefty increases in debt during the 1980s in all sectors of the U.S. economy were a source of widespread 'the-country's-going-to-the-dogs' handwringing by pundits and professionals alike. As the top chart reveals, after three decades of stability, the 1980s increase in the total debt-GNP ratio was indeed dramatic.

If debt is a sin, the United States has not been the lone sinner.

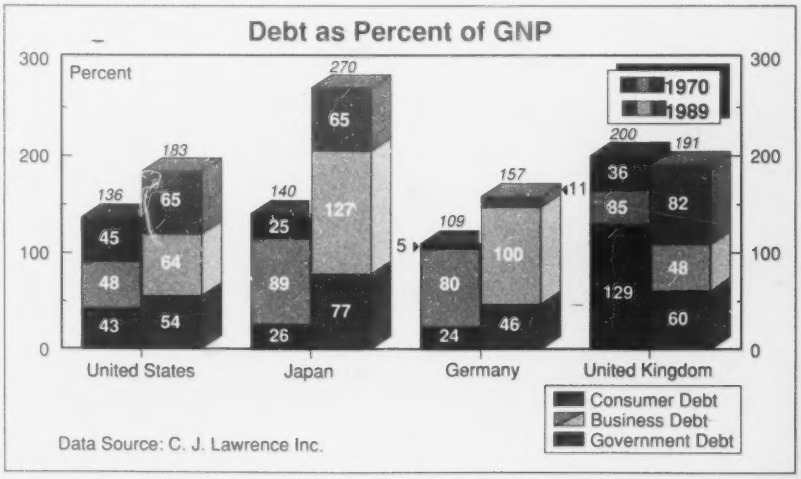
Stephanie Pomboy and Ed Hyman at C. J. Lawrence have now pulled together some comparable data on nonfinancial debt in four of the largest economies, and the comparisons are fascinating (bottom chart). If high and rising debt is a sin, it turns out that the United States has not been the lone sinner. Japan, often regarded as the paragon of economic performance, uses more debt and has increased its debt over the past two decades faster than the U.S., indeed faster than any of the other three. The United Kingdom, although it is the only country of the four to experience a declining debt-to-GNP ratio since 1970, is still a bigger debt user than the U.S. Only Germany is lower than the U.S., and even that financially conservative nation has seen its ratio rise as sharply as the U.S. ratio over the past two decades.

A glance at the sector-by-sector debt numbers (again measured as a percent of GNP) also provides some surprises. The biggest shock (to me at least) is the Japanese ratio of consumer debt to GNP, the fact that it is now the same size as ours and has increased so explosively since 1970. The British ratio is even higher. Consumers in Germany, however, deserve their reputation for frugality, judging by their nearly invisible (11 percent) debt ratio.

The business and government debt ratios are not especially remarkable, except for the stunning drop since 1970 in the British ratio of government debt to GNP. Evidently Mrs. Thatcher's privatization programs made an enormous difference.

How much comfort should anyone who worries about the economy overdosing on debt derive from these comparisons? Are the numbers we see here telling us that the *whole world* is coming to an end simultaneously? Or should we conclude that maybe the world is *not* coming to an end after all? Many years ago, before I looked into this quality-of-credit issue (and learned just how amorphous and impenetrable it really is), I worried about it quite a lot. I still worry about the nation's saving-investment ratio (another issue that is much more complex than I once thought). But on the debt bet, my nickel (no more) is on the optimistic side.

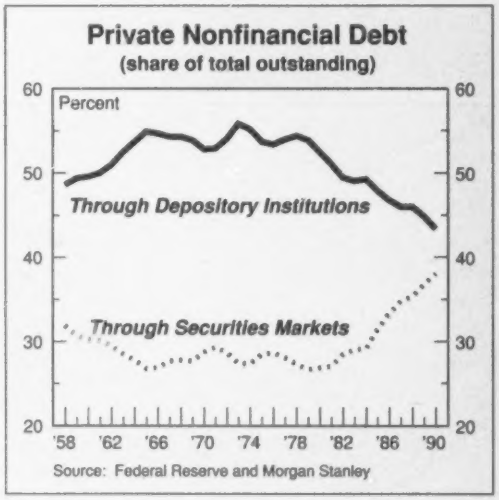
On the debt bet, my nickel (no more) is on the optimistic side.



Quotable Quote *by John D. Paulus*

Looking ahead over the next few years, one of the major issues is how much impact the present paralysis in the banking system might have — by retarding total lending in the financial system — on economic growth. The issue is addressed in the accompanying chart, the top line of which shows the sharply reduced share of private credit created through the commercial banks, savings and loan associations, and other depository institutions.

Such worries, however, ignore the second line on the chart, which shows how securities-market lending — principally commercial paper, corporate bonds and mortgage-backed securities — is taking up a portion of the slack let out by the more conservative loan policies of the distressed depositories. This shift in the composition of lending has been in progress since the early 1980s, with the securities market share now up to 40 percent. Thus, while the contraction in lending by the banks and S&Ls *could* pose a serious problem for economic growth if securities-market intermediation were to decline as well, at this time there is no reason to believe that such a retrenchment is imminent.



John D. Paulus is Managing Director and Chief Economist at Morgan Stanley. This commentary is excerpted from his essay, "Economic Growth and Structural Challenges in the 1990s: The Case for Optimism," in *Economic Perspectives*, February 1991.

Only in New York City

The silliness of St. Patrick's Day in New York City used to be confined to green bagels and green beer, but that was a more innocent age. Today, special-interest politics has lifted the vacuity to new heights, and the *New York Times*' coverage (March 17, 1991, front page) of the city's 230th Saint Patrick's Day parade reads as follows:

Late for a parade that he had passed up the chance to lead, Mayor David N. Dinkins was booed for nearly 40 blocks yesterday and briefly showered with beer as he and other elected officials marched up Fifth Avenue with a gay Irish group in the St. Patrick's Day Parade.

The Mayor, who had threatened not to march at all, ducked under an umbrella when two beer cans sailed toward him.

But that did not shield him from the rolling chorus of taunts and epithets and angry signs protesting his decision to join ranks with the lesbian and gay group, which the parade organizers had barred until Mr. Dinkins intervened.

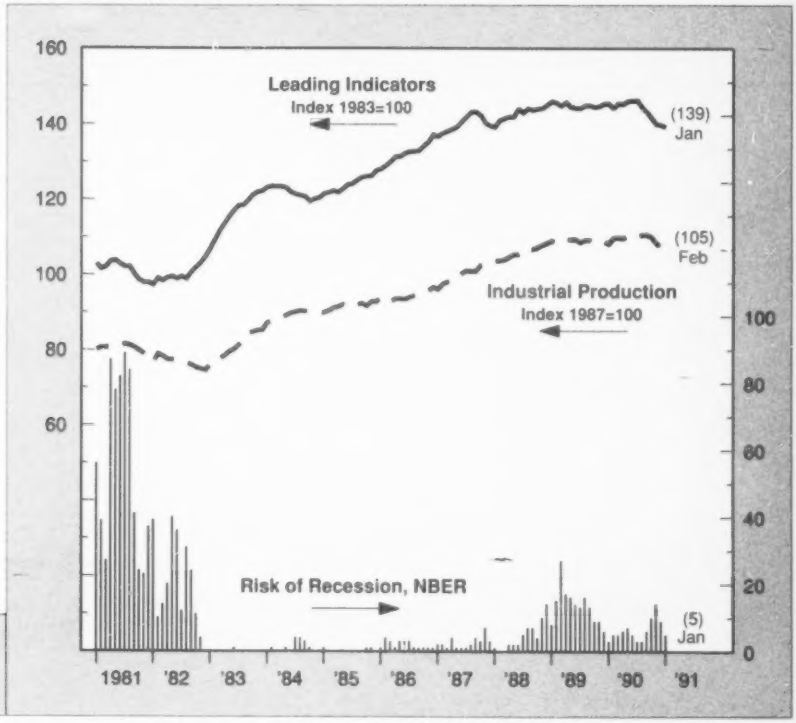
Governor Mario M. Cuomo also gave up a place at the front of the parade, marching with a group of handicapped children in wheelchairs that had been denied a place among the bands and bagpipes until they threatened to sue the parade organizers....

I don't know whether to laugh or cry.

Conference Board Stat File

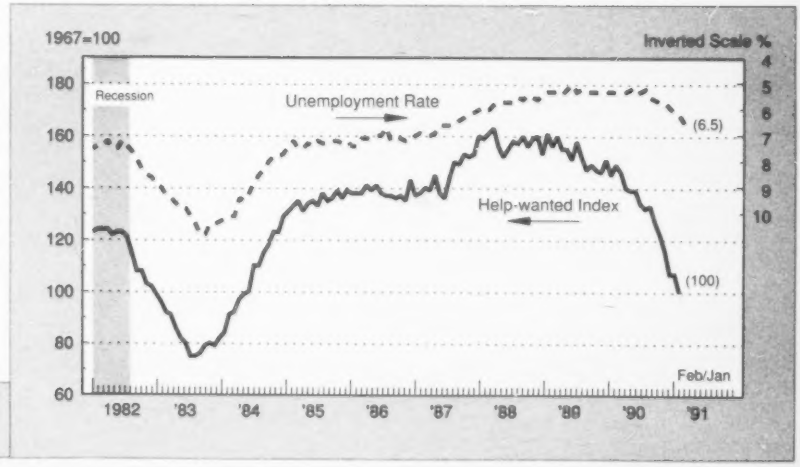
As the charts on this page illustrate, the downward phase of the business cycle continues to dominate the comprehensive economic indicators. On the following two pages, however, (and in other data) we find hints of a recession bottom beginning to take shape — in, for example, the momentum and confidence indexes. The recovery in consumer expectations is no surprise, given the victory in Iraq, but the fourth-quarter strength in capital appropriations is decidedly out of pattern. It's still too soon to say recovery is imminent, but not too soon to consider that possibility. The disturbing element in the current picture is the stubbornness of inflation. We still believe some slowing of the inflation rate lies ahead, but why hasn't any of it showed up by now?
(Note: Data for Conference Board series in this section are available upon request from Ken Goldstein at 212-339 0331.)

Early Warning Indicators



Leaders and production are still portraying a garden-variety recession; NBER calculation is thoroughly strange.

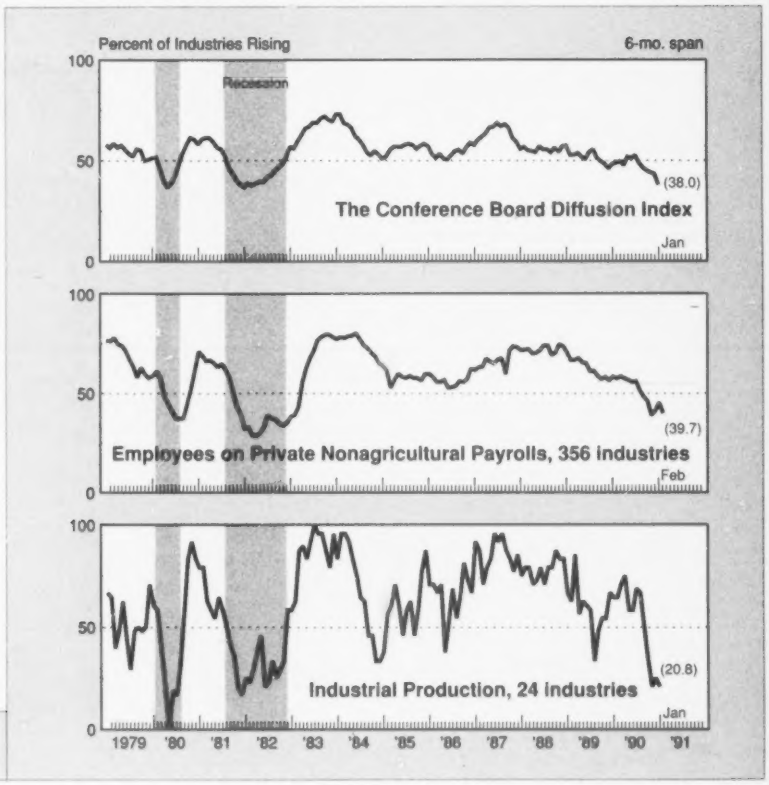
Help-wanted Advertising and Unemployment



No signs of a turn in the labor markets.

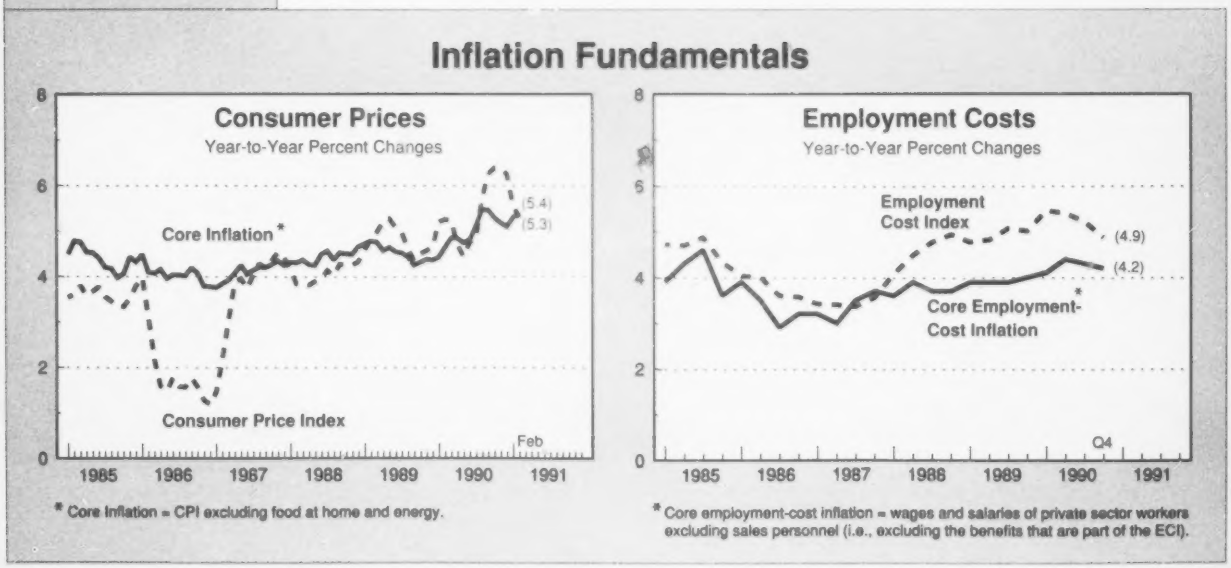
Conference Board Stat File

Indexes of Economic Momentum



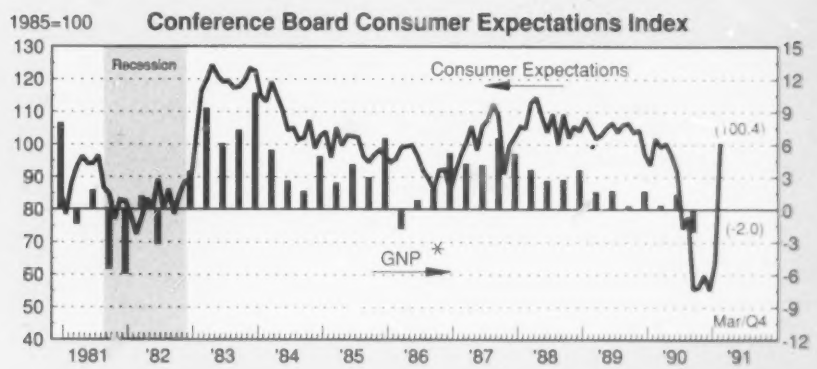
Some hints of a bottoming in cyclical momentum.

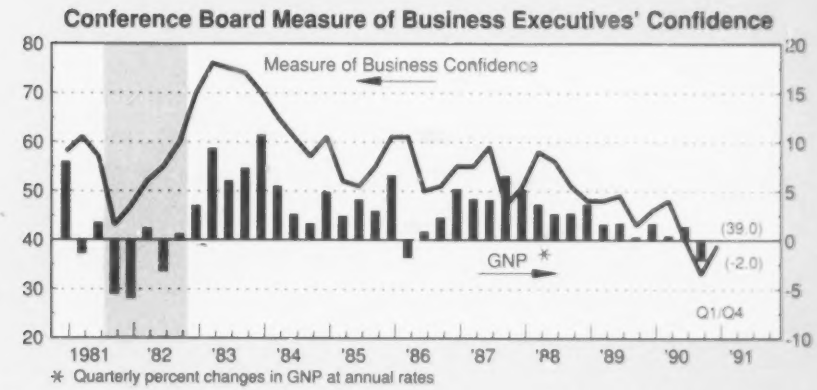
Inflation momentum persists — disturbingly.


Inflation Fundamentals
Consumer Prices
Year-to-Year Percent Changes
Core Inflation *
(5.4)
(5.3)
Consumer Price Index
Feb
1985 1986 1987 1988 1989 1990 1991
* Core Inflation = CPI excluding food at home and energy.
Employment Costs
Year-to-Year Percent Changes
Employment Cost Index
(4.9)
(4.2)
Core Employment-Cost Inflation *
Q4
* Core employment-cost inflation = wages and salaries of private sector workers excluding sales personnel (i.e., excluding the benefits that are part of the ECI).

Conference Board Stat File

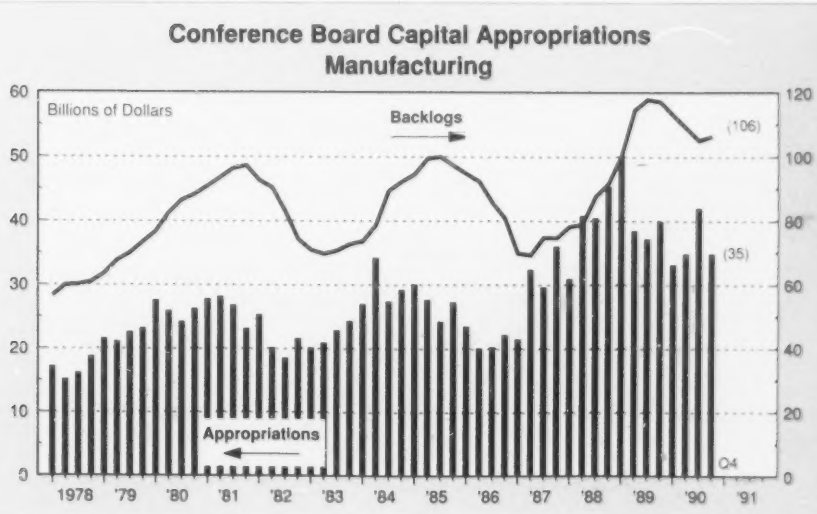
Confidence




Conference Board Measure of Business Executives' Confidence
Measure of Business Confidence
(39.0)
(-2.0)
GNP *
Q1/Q4
1981 '82 '83 '84 '85 '86 '87 '88 '89 '90 '91
* Quarterly percent changes in GNP at annual rates

Confidence improving — encouragingly.

Investment Intentions



Appropriations holding up surprisingly well.

Inside the Crystal Ball

			UCLA	MERRILL L.	DU PONT	GEORGIA ST.	NORTHERN TRUST	CONF. BOARD	EATON	L.H. MEYER	DRI	WEFA	MICHIGAN – RSQE			
Date of Forecast			Mar.	Mar.	Mar.	Mar.	Mar.	Mar.	Mar.	Mar.	Mar.	Mar.	Mar.			
Gross National Product																
(Quarter-to-quarter percent change, constant dollars, seasonally adjusted at annual rates)																
			%	%	%	%	%	%	%	%	%	%	%			
Actual	1990	3Q	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4	3Q	1990	Actual
		4Q	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0	4Q		
Forecast	1991	1Q	-2.5	-1.6	-1.0	-2.2	-2.2	-0.7	-2.0	-2.5	-2.3	0.5	-0.9	1Q	1991	Forecast
		2Q	-1.0	-0.8	-0.2	1.9	1.9	2.6	4.1	0.5	0.1	4.8	1.5	2Q		
		3Q	1.8	0.4	2.4	2.7	3.3	1.3	6.1	2.8	4.2	3.8	3.0	3Q		
		4Q	3.2	3.1	2.8	1.4	3.1	1.6	3.4	2.5	3.3	3.0	2.8	4Q		
	1992	1Q	3.9	3.0	3.2	2.7	3.0	2.4	3.2	3.2	3.5	3.2	2.9	1Q	1992	
		2Q	4.3	3.0	3.2	2.1	3.2	1.8	2.1	2.7	3.8	2.8	3.3	2Q		
		3Q	3.9		3.7	3.3	3.2	2.2	2.4	2.6	3.1	3.0	3.7	3Q		
		4Q	2.6		4.0	1.5	3.0	2.4	2.0	2.5	2.3	2.6	3.6	4Q		
	1993	1Q	2.8		3.8			2.4	2.3	3.1	3.1	2.8		1Q	1993	
Inflation (GNP Deflator)																
(Percent change from same quarter one year earlier)																
Actual	1990	4Q	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	1990	4Q	Actual
Forecast	1991	4Q	3.7	4.0	3.6	4.1	4.1	4.2	2.7	3.2	2.9	2.8	3.8	1991	4Q	Forecast
	1992	4Q	2.6		3.9	3.9	3.9	4.6	2.7	2.5	3.1	3.1	3.6	1992	4Q	
Unemployment Rate																
(Percent, quarterly)																
Actual	1990	3Q	5.3	5.3	5.3	5.3	5.3	5.3	5.3	5.3	5.3	5.3	5.3	3Q	1990	Actual
		4Q	5.9	5.9	5.9	5.9	5.9	5.9	5.9	5.9	5.9	5.9	5.9	4Q		
Forecast	1991	1Q	6.4	6.3	6.4	6.3	6.3	6.4	6.5	6.3	6.5	6.4	6.5	1Q	1991	Forecast
		2Q	6.8	6.9	6.8	6.4	6.6	6.5	6.8	6.6	6.9	6.5	6.8	2Q		
		3Q	6.9	7.0	6.8	6.4	6.5	6.6	6.7	6.7	7.0	6.1	6.8	3Q		
		4Q	6.7	6.9	6.8	6.6	6.4	6.6	6.5	6.7	6.9	6.0	6.7	4Q		
	1992	1Q	6.5	6.6	6.7	6.6	6.3	6.5	6.4	6.6	6.7	5.9	6.7	1Q	1992	
		2Q	6.3	6.5	6.5	6.6	6.2	6.5	6.3	6.5	6.5	5.9	6.6	2Q		
		3Q	6.1		6.3	6.3	6.1	6.4	6.3	6.3	6.3	5.8	6.4	3Q		
		4Q	5.9		6.1	6.2	6.0	6.4	6.3	6.2	6.2	5.8	6.3	4Q		
	1993	1Q	5.8		5.9			6.3	6.3	6.0	6.1	5.8		1Q	1993	

Industry Outlook Report

April 1991

Overview

Edgar R. Fiedler
The Conference Board

The industry specialists reporting on the outlook for the next year or so reflect a curious mix of nonchalance and pessimism--quite typical, I believe, of the current views of the U.S. forecasting fraternity. The nonchalance is about the recession. It doesn't worry them much at all. They don't expect the slide to go very far, either in depth or in duration. Except for John Macleod, our somewhat more concerned friend from Down Under, it's likely none of the group would argue strongly with a projection that the recession will end around mid-year.

At the same time, the group's expectations about the recovery are uniformly restrained. Dave Berson's forecast of "a fairly modest increase in [home] sales,...compared with previous economic expansions" is typical. Correspondingly, Tom Will sees "shipments of original equipment auto tires [dropping] some six million units" in 1991, along with a "replacement market that is flat to down." Thus while the recession is not a matter of serious concern to the group, prospects for the subsequent recovery are anything but a cause for celebration.

Perhaps the most difficult question about the outlook for 1991 and 1992 is how much it will be affected by the troubles of the banking industry. The consensus view is that the depository institutions — the commercial banks as well as the thrifts — are nearly paralyzed by their problems in real estate and elsewhere. Thus they will not be willing to support a cyclical recovery with the same kind of free-wheeling lending policies they normally deployed in past recoveries. Bill Dunkelberg, however, says 'tain't so. The small businesses in his survey simply are not reporting serious trouble in finding credit — nothing like 1981-82. That is an intriguing piece of evidence, although it will not, I'm sure, be universally accepted at face value by all our readers.

Health

Jack A. Meyer
New Directions for Policy

Health care costs have been rising about 3.8 percentage points more than the growth in our nominal gross national product. In the absence of major structural reforms in our health care system, this trend will continue. This would push health spending from an estimated $670 billion in 1990 to about $745 billion in 1991 and about $830 billion in 1992. By the year 2000, health costs would total nearly $2 trillion under this forecast, accounting for over 17 percent of GNP, compared with about 12 percent today. At the same time as costs are soaring, at least one of eight Americans has no health insurance, while millions more are under-insured.

Powerful forces are pushing health costs upward. New medical technology is being developed at a rapid pace. Federal tax and subsidy systems underwrite the over-consumption of health care services even as they leave large segments of low and moderate income families out in the cold. The aging of our population, AIDS, drug and alcohol abuse, and our medical malpractice system, all add to health-care costs.

The business sector can help by, for example, encouraging the delivery of care in cost-effective settings, and emphasizing early detection, diagnosis and screening. Government policy reforms can support these private initiatives. The government can place a ceiling on the open-ended exclusion of employer contributions to health insurance from employees' income tax liability. The additional revenues could fund a broadening of publicly assisted health coverage through either refundable tax credits earmarked for insurance premium contributions or Medicaid expansion.

Government and the private sector can sponsor research to uncover unnecessary surgery and questionable diagnostic tests. Regulatory reforms could include limits on insurers' ability to deny coverage to people in high-risk categories or to price such coverage beyond their reach. Tort reform could also help control astronomical settlements in malpractice cases. Given the explosion of medical technology and looming demographic changes, however, we will also have to make greater use of rationing if we are to decelerate the growth rate of health care costs.

Electronics

Richard O'Brien
Hewlett-Packard

The worldwide market for electronic equipment and components increased from $710 billion in 1989 to $760 billion in 1990, a modest growth of 7 percent. U.S. industry performance was boosted by a surge in exports, as the domestic market was constrained to a 4 percent growth rate. 1991 is expected to be another modest year. However, a small upturn in the medium-term will follow as the investment cycle strengthens.

The computer sector grew modestly in 1990 at a rate of 7 percent. Given the shaky financial results of 1990, and the predicted downturn in capital equipment spending in early 1991, computer equipment will probably post another mediocre performance. A strong rebound is predicted in 1992, as the decline in the dollar will still translate into robust export growth rates.

The size of worldwide military procurement budgets will continue to be the single most important factor affecting growth in communication equipment demand. Communications equipment, primarily military electronics, will probably capture a larger share of the declining U.S. defense budget. Fast-growing segments include local area networks, satellite terminals, fiber optics, the cellular segment, navigation equipment, and communication services. Telecommunication equipment will be susceptible to the economic downturn in 1991. Growth in communication equipment should resume in 1992.

The components industry continued to decelerate in 1990, with the pace of growth at 4 percent. Growth has been impacted by the slowdown in the computer and telecommunications industries. However, the current industry cycle is apparently bottoming. Because the downturn has been relatively mild, the recovery expected in 1991 will not be as sharp as in past cycles.

The demand for instruments is forecast to remain slow for most of 1991, reflecting lower overall growth in plant and equipment. Test and measurement is impacted by the downsizing of defense orders and an uneven pattern in commercial orders. Luckily, dollar-denominated international shipments benefit from the slide of the U.S. dollar. Analytical instruments will also slow in 1991, but long-term prospects remain good. Renewed emphasis on the environment and accuracy in testing will contribute to growth. Medical electronics has been a standout for its growth rate and relative lack of volatility.

Tires and Rubber

Thomas F. Will
Goodyear Tire and Rubber

In the 1980s, the industry was caught up in the takeover and merger frenzy. When the smoke cleared, three companies, Goodyear, Michelin/UTG, and Bridgestone/Firestone, accounted for 58 percent of the world's tire supply. Consolidations promoted reorganization and nurturing of total quality environments. In 1990, these merged companies, eager to move ahead, fell into a severe struggle for market share. This situation was exacerbated by the slowing economy and the Iraqi invasion of Kuwait. As a result, the industry's 1990 profitability was destroyed.

Outlook

As the industry headed into 1991, consumer confidence and vehicle sales were at recessionary levels, and the Middle East war was on the immediate horizon. Plans were made to accommodate demand and production levels close to 1982 recession levels. Fortunately, the gloomy outlook has eased somewhat with the successful conclusion of the lightning quick 43-day war. This may buoy consumer confidence and move the consumer away from CNN to the retail mall.

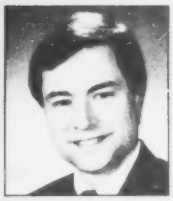
Even so, auto and light truck sales could fall some 8-10 percent, and industry shipments of original equipment auto tires could drop some six million units.

Growth in the replacement auto tire market is dependent upon miles driven per vehicle. We anticipate that this will flatten out this year. Coupling this with lower registration growth and longer-wearing tires will result in a replacement market that is flat to down in 1991.

On the truck tire side, truck tonnage and small business activity plummeted in the last few months of 1990 and remain at a low level. Tire demand for medium and heavy trucks will be 10 percent below 1990 levels. Demand on the replacement side will follow any pickup in consumer buying. For the year, look for replacement truck tire demand to be flat at best.

With low demand levels in an industry with too much supply, we look for industry profits to be slim in 1991 but much improved in 1992.

Housing



David W. Berson
Federal National Mortgage Association

The housing market typically leads the economy into recession, and the current downturn has proven to be no exception. In the year ending January 1991, housing starts declined by nearly 45 percent, new home sales dropped by almost 35 percent, and existing home sales were down by about 16 percent — with most of the declines occurring after the Iraqi invasion of Kuwait in response to the sharp drop in consumer confidence. The initial slowing in the housing market last year came as a result of dwindling pent-up demand after strong sales and production years in the 1980s and tougher lending standards for builders — not the typical affordability problems that usually afflict the housing market before recessions.

If, as most expect, the U.S. economy turns around in the second half of 1991, the housing market, too, should recover. This recovery, however, is likely to be both more uneven and less robust than usual. Home sales should rebound more strongly than home construction over the second half of the year, with rising consumer confidence and the highest levels of affordability since the late 1970s. Mortgage lenders have already seen a substantial rise in applications to refinance existing mortgages, and a pickup in consumer confidence coming from the successful end of the war should soon boost sales. A lackluster economic recovery combined with only small increases in pent-up demand are likely to lead to a fairly modest increase in sales, however, compared with previous economic expansions. Housing starts may lag behind sales because of builder caution and continued tight depository-institution regulation that makes it more difficult for builders to borrow funds, especially for acquisition and development purposes.

Housing Starts
(millions)

1990 *(actual)*	**1991***(forecast)*
1.20	**1.09**

For 1991 as a whole, both new and existing home sales should be similar to their levels of last year—a combined total of about 3.8 million sales. Housing starts, however, are expected to decline by about 9 percent this year, to the lowest level since 1982 — about 1.09 million units.

Freight Transportation

Kenneth D. Simonson
American Trucking Associations

All transport modes had a bumpy ride in 1990. Soaring fuel prices, a sharp loss of confidence by business and consumers, and a rapid military buildup in the Persian Gulf made for sudden swings in patterns of freight movements and costs for each mode.

The remainder of 1991 and 1992 should be much closer to the normal pattern for freight transportation; that is, volumes will generally sink or rise with the level of industrial production. (industrial production will probably be a better bellwether than gross national product, since freight reflects goods production — almost by definition — and not services.)

Gradually, however, the fate of even the land-based modes is becoming more tied to foreign economies. Trucks, on which more than three-quarters of the nation's freight bill is spent, have charged into Canada in great numbers since Canadian deregulation and the Free Trade Agreement lowered the barriers. Truckers are eager to do the same in Mexico. Rails have been delivering increasing quantities of freight to and from ports, thanks to through trains hauling double-stacked containers.

Air and ocean freight may get a small fillip from the rebuilding and demobilization in Kuwait, but this will not be enough to make up for sluggishness in other export markets or for a slow recovery in the U.S. appetite for imports.

No dramatic shifts are likely in how the freight bill is divided among modes. Instead, look for continued consolidation within each mode — at an accelerated rate if recovery does not come soon.

Minerals

John D.S. Macleod
CRA Limited
(Australia)

The outlook for mineral volumes and prices is for a period of further weakness. The main driving force, and the main variable, is the condition of the major world economies.

As I write it is clear that world economic growth is slowing, the English speaking nations are in recession, and recovery (especially in the US) if it occurs later this year is likely to be weak. The growth locomotives in the World are Germany and Japan. Many of the smaller Asian economies could well be included in this growth leader group.

For the minerals industry to prosper we need World GNP growth of 2.5 to 3.0 percent per annum. Such growth is unlikely in either 1991 or 1992. On this basis some further weakening of metal prices could occur although the big falls that have already occurred may mean that present prices may be close to the bottom. Remember that the price of aluminum is off 33 percent from its peak last year, copper 30 percent and zinc 36 percent.

The world mining and processing industry entered this period of slowing world growth in most unusual conditions. Supply and demand for most metals is in near balance. Inventories are modest for this stage of a cycle but, even more unusual, new capacity added over the past year or so has been relatively modest. Finally, producers have lowered their debt levels and many go into this downturn with strong balance sheets.

The reasons why capacity additions have been so modest in the past two or three years are interesting. The first half of the 1980s was a period of inadequate prices, excess capacity and high gearing. When market conditions improved, the rising profits were used to repay debt, increase dividends and upgrade plant and equipment. It was also a period when gold dominated the industry; in particular, mineral exploration expenditures were focused almost exclusively on gold. The result has been many new gold mines but few other major orebodies.

Conservation, environment, heritage, national parks and native lands are all factors which hindered new mineral development in the '80s. They remain as a big question mark over future supplies of minerals and energy in the '90s.

Small Business

William C. Dunkelberg
National Federation of Independent Business

The small business economy continued weak in early 1991, but the latest survey of attitudes among small-firm executives shows a recovery in optimism from the depressed levels of late 1990. About two-thirds of last year's decline in attitudes was retraced by this February, but sentiment remains low, indicating a weak near-term economy.

In line with the general economy, expected business conditions for the nation's independent enterprises remain very soft. Hiring plans are weak, indicating that unemployment will continue to rise. Inventory positions are in a healthy condition, but declining sales have nevertheless taken a toll on inventory satisfaction.

A large number of executives report that weakness in sales has forced them to lower selling prices. Indeed, sales projections for the year ahead are anemic. Declines in sales are outpacing cost reductions, taking a toll on cash flow and profits. In turn, capital spending plans among independent business people have remained at a low level for six months now, and are likely to sag further until a general economic rebound appears.

Credit Crunch? During this recession, much has been made of the idea that many banks are *unusually* reluctant to lend to borrowers to whom they would have willingly lent in the past. Members of the National Federation of Independent Business have been surveyed regularly since 1973 about their borrowing experience. These surveys show that a modest credit crunch took place in 1974-75, and a severe crunch occurred in 1981-82. In the latter case, 32 percent of the executives surveyed reported credit to be harder to get, compared to only 14 percent currently, and 48 percent reported higher interest rates, compared to only 8 percent currently.

Furthermore, when Federation members were recently asked about their most important problem, taxes top the list, and "credit availability" is near the bottom. Doesn't sound like much of a CRUNCH, does it? It's not! The survey shows credit to have tightened somewhat in the past few months but, no, this is not anything that deserves to be called a "credit crunch."